

Indirectly Beneficial, Mike Taylor, C.P.M.

In my recent seminar I suggested analyzing the selling price of materials and services to negotiate a better contract. That is, by looking at the various cost elements involved in establishing the price, we can find opportunities to be creative in negotiating cost savings. With direct cost elements, it is usually obvious how to impact the bottom line and improve the contract. Changing the raw material, shipping terms, components, labor mix, schedule, etc. are common ways to improve the pricing structure. Read more about negotiating direct costs.... www.mltweb.com/tools/articles/Costcounts.htm

What about indirect costs? Indirect costs are expenses included in the selling price which are allocated to multiple projects and customers using indirect cost pools. Expenses like the seller's accounting department, CEO, supply chain, marketing or engineering departments. Read more about indirect costs.....
www.mltweb.com/tools/articles/indirect_cost.htm

On the face of it, it seems implausible to negotiate indirect costs associated with the supplier's accounting department or company president out of the contract. I agree – it's nearly impossible to get a better contract by trying to cut indirect costs out of the deal.

But consider for a minute that negotiating a better contract isn't always about saving money. A more valuable, cost-effective and complete contract is also a much better contract. Read more about negotiating more than just price... www.mltweb.com/tools/articles/negotiate2.htm

So here is a thought. Instead of only concentrating on cutting direct contract costs – think about taking advantage of the indirect costs already included in the seller's price. Negotiate a contract that identifies and makes better use of every possible benefit available and already included in the price as indirect costs.

Example: A pump equipment company might advertise free field installation technical assistance in aligning the pump coupling. When we order a pump, we pay for the advertised technician whether he is used or not. Unfortunately, all too often this free service is not used. Instead of potentially wasting that extra benefit, a better approach would be to ensure the contract includes a deliverable for the technician's service and an agreed installation schedule with plant maintenance.

Seem a little obvious? Sure, but if the contract document isn't complete, the technician's service (which is already paid for) could be missed because of scheduling problems or changes in personnel. Once we understand that this overhead expense is already included in the selling price, then it makes a lot of sense to be sure it is clearly part of the contract negotiation and identified as a deliverable.

What else could we be taking advantage of? Try opening the subject by asking a seller to identify all of the 'hidden' or 'included' advantages of doing business with his company. Sellers love to talk about all the good things their company can do. Make sure to get lots of details and ask lots of questions. Then be sure to write all of those extras in to the next contract.

The contract price for the equipment might not drop much in a negotiation, but if I can also get free setup, technical training, maintenance scheduling, annual inspections, etc. then I have added a lot of value.

Here are some examples of overhead cost items to include in contracts. These are all costs sellers might have buried in overhead rates that will add value to a contract.

- ❑ Recycle, reuse and/or exchange of supplies and worn components or disposal of residual hazardous materials *[The filter medium will be returned for recycling and credit. The residual hydraulic fluid will be picked up at the next delivery so I don't have to pay to dispose as hazardous materials]*
- ❑ Recycle and/or reuse of packaging and packing materials or freight backhaul *[Can the delivery truck backhaul something of mine or pickup something else on the way?]*
- ❑ Field engineer for installation, testing, troubleshooting, failure analysis *[The technical service visits are scheduled for X, Y & Z to coincide with our planned maintenance outages]*
- ❑ Publicity and PR materials that can help advertise buyer's product or services *[think of PC manufacturers getting advertising stickers and TV ads from INTEL for the Pentium chips they use in PCs]*
- ❑ Books, manuals, background information, technical data, drawings, instruction guides *[please send 15 extra quick-reference maintenance guides to post in our shop]*
- ❑ Accounting department assistance in setting up more efficient billing and payment processes
- ❑ Usage reports, on-time delivery analysis, similar-item analysis *[since you already get a sales report showing our orders, please send me a copy on the first of each quarter]*
- ❑ Salesmen, marketing people or even the division president. *[If I am going to pay for a salesman and take the time to talk with him, then I will ensure he comes prepared at each visit with parts lists, service recommendations, alternative solutions and more efficient ordering methods. I might schedule the Seller's company president to meet with Buyer's company president and discuss a long-term relationship].*
- ❑ Product demonstrations, training and training materials *[The equipment expert will arrive on X to conduct training for all of buyer's staff and maybe even some customers. Three copies of the product demonstration tape will be included]*
- ❑ Licensing or regulatory assistance *[If the EPA elects to inquire about product compliance, then a licensing or product expert will arrive to assist with the interview and audit. Seller's licensing team will assist in completing the application.]*
- ❑ Alternative packaging that can be reused within the buyers' processes *[ship the product on pallets that will fit into our storage racks so we can reuse them]*
- ❑ Quality Assurance or Inspection verification *[The quality control supervisor will visit the job site every month to ensure that provided services meet all expectations]*
- ❑ Trained Workers. *Buyer's maintenance personnel will have three slots at the next factory training program.*
- ❑ Special Handling and inspection. *As part of seller's 100% inspection process, mark the parts with our part number at the same time.*

The idea is to write the most valuable contract you possibly can. **Use every penny of your supplier's indirect costs to get direct benefits in your contract.**

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